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In the Supreme Court of the United States

OCTOBER TERM, 1948

No. 682

MATHER & Co., PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

*ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED
STATES COURT OF APPEALS FOR THE THIRD CIRCUIT*

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The opinion of the Tax Court (R. 17a-25a) is reported at 7 T. C. 1440. The opinion of the Court of Appeals (R. 29-39) is reported at 171 F. 2d 864.

JURISDICTION

The judgment of the Court of Appeals was entered January 3, 1949 (R. 40). The petition for a writ of certiorari was filed March 31, 1949. The jurisdiction of this Court is invoked under 28 U. S. C. 1254.

QUESTIONS PRESENTED

This case presents the question whether under Section 113 (a) (8) of the Internal Revenue Code the cost basis of real property transferred to a corporation by the members of a partnership in exchange for all of the corporate stock and the assumption of the transferors' liabilities, is the same as it was in the hands of the transferors. This directly depends on whether the exchange was tax-free in that it met the requirement of Section 112 (b) (5) that "the amount of the stock and securities received by each * * * [transferor be] substantially in proportion to his interest in the property prior to the exchange". This, in turn, depends on the answer to two independent questions:

(1) Whether the amounts of liabilities assumed by the transferee may, as the Tax Court and the court below held, be considered as "stock and securities received by" the transferors in determining whether the statutory test is met, although, disregarding the assumed liabilities and considering only other assets transferred, that test is not met; and,

(2) Whether the statutory test requires a comparison between the percentage interest held by each transferor in the transferred property before, and his percentage interest in the corporate stock and securities after, the exchange, as the court below held, rather than a comparison between the change in value of each transferor's

interest after the exchange with the change in value of every other transferor's interest.

STATUTES AND REGULATIONS INVOLVED

Internal Revenue Code:

SEC. 112. RECOGNITION OF GAIN OR LOSS.

(a) *General rule.*—Upon the sale or exchange of property the entire amount of the gain or loss, determined under section 111, shall be recognized, except as hereinafter provided in this section.

(b) *Exchanges Solely in Kind.*—

* * * * *

(5) [as amended by Sec. 213, Revenue Act of 1939, c. 247, 53 Stat. 862] *Transfer to Corporation Controlled by Transferor.*—No gain or loss shall be recognized if property is transferred to a corporation by one or more persons solely in exchange for stock or securities in such corporation, and immediately after the exchange such person or persons are in control of the corporation; but in the case of an exchange by two or more persons this paragraph shall apply only if the amount of the stock and securities received by each is substantially in proportion to his interest in the property prior to the exchange. Where the transferee assumes a liability of a transferor, or where the property of a transferor is transferred subject to a liability, then for the purpose only of determining whether the amount of stock or securities received by each of the transferors is in the proportion required by this

paragraph, the amount of such liability (if under subsection (k) it is not to be considered as "other property or money") shall be considered as stock or securities received by such transferor.

* * * * *

(26 U. S. C. 1946 ed., Sec. 112.)

The other pertinent statutes and regulations appear in the Appendix, *infra*, pp. 20-30.

STATEMENT

The facts as found by the Tax Court (R. 17a-22a) may be summarized as follows:

The taxpayer, a Pennsylvania corporation, was incorporated on December 1, 1926, as the successor to a company founded in 1887 by Charles Mather which went through various partnership phases, the final partnership, preceding the taxpayer's incorporation, having been formed in 1925 (R. 17a, 18a). The partners and their respective interests in the partnership property and earnings were as follows (R. 18a):

Charles Mather.....	35 percent
Victor Mather.....	25 percent
Gilbert Mather.....	20 percent
Josephine Mather.....	20 percent

On October 29, 1926, the partners entered into a written agreement, whereby they agreed to incorporate the business and form the taxpayer with an authorized capital stock of \$510,000, consisting of 5,000 shares of six percent cumulative preferred stock of a par value of \$100 per share, and 1,000 shares of common stock of the par value

of \$10 per share, and an agreed value at the time of transfer of \$50 per share. Only the common stock had voting rights (R. 18a).

Pursuant to the agreement all the assets and good will of the partnership, except those of the New York office, were transferred to the taxpayer. Accounts payable were assumed as a liability. The assets and liabilities were as follows (R. 18a):

Cash.....	\$162,963.18
Notes receivable.....	79,612.45
Accounts receivable.....	1,054,403.15
Bank stock.....	3,000.00
<hr/>	
Current assets.....	1,299,978.78
Real estate.....	150,000.00
Furniture and fixtures.....	35,000.00
<hr/>	
Total.....	1,484,978.78
<hr/>	

Partnership indebtedness (accounts payable)--- 1,290,978.78

The good will of the partnership was \$40,000 (R. 19a).

In the exchange the partners received the following number of shares of the taxpayer's preferred and common stock, the common stock being "issued in consideration of the purchase of the good will of the going business" of the partnership (R. 19a):

	Preferred shares	Common
Charles Mather.....	648	250
Victor Mather.....	462	250
Gilbert Mather.....	370	250
Josephine Mather.....	370	50
Total.....	1,850	800

The remaining 200 shares of authorized common stock were unissued (R. 19a).

In addition and also pursuant to the October 1926 agreement, Charles Mather subscribed for the remaining 3,150 shares of preferred stock. These shares were issued to him in exchange for his promissory note in the amount of \$50,000 and the conveyance to the corporation of certain parcels of realty in Philadelphia. Both parcels were owned individually by the transferor at the time of the transfer late in December 1926, and the transfer was made effective as of January 1, 1927 (R. 19a). As of December 31, 1926, these parcels of realty had a combined fair market value of \$465,000 but were encumbered by mortgages aggregating \$200,000. Each parcel was transferred to taxpayer subject to its respective mortgage (R. 20a).

The following tabulation (which we have designated as Table I) shows the values of the properties transferred to the taxpayer, the amount of indebtedness assumed by the taxpayer, the total value of stock and indebtedness received by or attributable to each transferor,¹ and the gain or loss of each; good will is valued at \$40,000, common stock at \$50 per share, preferred stock at \$100 per share (R. 19a):

¹ The partnership indebtedness assumed by the new corporation is distributed according to each partner's percentage interest in the partnership. The indebtedness attributed to Charles Mather as an individual represents the mortgage debt assumed by the taxpayer.

TABLE I

	A Value of properties transferred	Values received			E Total in- debtedness and stock	F Gain (Loss)	G Percentage of column F to column A
		B Indebted- ness	C Preferred stock	D Common stock			
Charles Mather (individual):							
Real estate.....	\$465,000.00						
Note.....	48,000.00						
Charles Mather (partnership), 30% interest.....	\$515,000.00	\$200,000.00	\$215,000.00		\$515,000.00		
Victor Mather (partnership), 20% interest.....	533,742.37	494,992.37	64,800.00		532,292.37	(81,438.00)	-0.37106697%
Gilbert Mather (partnership), 30% interest.....	381,244.76	284,084.76	46,200.00		383,094.76	2,480.00	+0.6438119%
Josephine Mather (partnership), 30% interest.....	304,995.75	259,095.75	37,000.00		309,495.75	4,500.00	+1.475457%
Total.....	2,039,978.78	1,460,978.78	860,000.00	40,000.00	2,039,978.78	(5,500.00)	-1.803308%

The difference between the greatest gainer and the greatest loser is less than 3.28 percent (R. 20a).

The basis of taxpayer's transferor (Charles Mather) for the real properties in question is as follows (R. 20a, 22a):

	Land	Buildings	Total
1226 Arch Street.....	\$75,250.00	\$6,468	\$81,718.00
1227 Arch Street.....	\$8,870.67	6,468	\$6,047.67
2009 Chestnut Street.....	15,000.00	5,000	20,000.00

In his individual income tax return for the calendar year 1926, Charles Mather reported a gain of \$124,700 upon the transfer of these properties and an income tax liability of \$15,587.50 thereon. Neither Charles Mather nor any of the other partners of Mather & Company reported in their income tax returns any gain or loss on the exchange of partnership assets, under and subject to all partnership liabilities, to the taxpayer for taxpayer's preferred and common stock (R. 20a).

On December 31, 1942, taxpayer sold the Arch Street property for the sum of \$20,000 and incurred expenses in connection therewith of \$1,025. It claimed a loss as a result of the sale in its 1942 income tax return in the amount of \$270,000, computed as follows (R. 21a):

Cost.....	\$350,000
Depreciation, allowed or allowable, being the full value of the improvements (buildings were torn down in 1934).....	60,000
	<hr/> 290,000
Gross sales price.....	20,000
	<hr/>
Claimed loss.....	270,000

The Commissioner disallowed the claimed loss and also disallowed as a deduction the expenses of \$1,025 (R. 22a). On December 30, 1943, taxpayer sold the Chestnut Street property for the sum of \$2,500 and incurred expenses in connection with the sale of \$128.50. It claimed a loss on its 1943 income tax return of \$82,500, computed as follows (R. 22a):

Cost.....	\$115,000
Depreciation allowed and allowable, being the full value of the improvements (buildings were torn down in 1936).....	30,000
	<hr/>
Adjusted basis.....	85,000
Gross sales price.....	2,500
	<hr/>
Claimed loss.....	82,500

The Commissioner disallowed the claimed loss and also disallowed as a deduction the expenses of \$128.50 (R. 22a).

As noted above, the taxpayer had assumed liability on the mortgages on both pieces of property, (*supra*, p. 6). Shortly prior to the sale of the Arch Street property the taxpayer paid off the balance due on the mortgage in the amount of \$79,538.50; shortly prior to the sale of the Chestnut Street property the taxpayer paid off the

balance due on the mortgage in the amount of \$30,000 (R. 22a).

Throughout the entire period that the Arch and Chestnut Streets properties were owned by the taxpayer they were rented. Depreciation upon the buildings was claimed and allowed until their demolition. The Arch Street buildings were demolished in 1934, and a deduction of \$51,600 was claimed and allowed; the Chestnut Street buildings were demolished in 1936, and a deduction of \$26,540.35 was claimed and allowed. These amounts represented the 1926 values of the buildings, less depreciation claimed to year of demolition (R. 22a).

The Tax Court held (R. 25a) that the transfer to the taxpayer fell within the tax-free provisions of Section 112 (b) (5), Internal Revenue Code, as amended, *supra*, pp. 3-4, and that the taxpayer's basis was therefore the same as in the hands of its transferor, Charles Mather. That decision concerned itself solely with the first of the two questions presented, *supra*, pp. 2-3 (R. 22a-25a). The Court of Appeals affirmed (R. 32-39) and considered both the questions now in dispute.

ARGUMENT

Two separate issues are presented by the taxpayer's petition. Both of them were decided in the Commissioner's favor by the court below and either is dispositive of the case. As to issue No. 1, *supra*, p. 2, there is concededly no conflict of

decisions, this being a case of first impression. The decisions of the Tax Court and the Court of Appeals were clearly correct on that issue, and there is no need for further review. And while the second issue (*supra*, pp. 2-3) may present a technical—though not an actual—conflict, this case does not provide a proper occasion for disposition of that question, in view of the independent nonconflict ground which requires a determination in favor of the respondent in any event.

Issue No. 1.—Section 112 (b) (5) *supra*, pp. 3-4, provides one of several exceptions to the general rule that upon an exchange of property the entire amount of the gain or loss which has accrued at the time of the exchange will be recognized. The exception covers those cases in which property is transferred to a corporation by one or more persons solely in exchange for its stock and “if the amount of the stock and securities received by each is substantially in proportion to his interest in the property prior to the exchange.”

The taxpayer concedes that all the requisites of a tax-free exchange were met except for the latter requirement.

The first issue involves a construction of the second sentence of Section 112 (b) (5) which permits, solely for determining the proportionate interests under the statute, liabilities of the transferors which are assumed by the transferee to be “considered as stock or securities.” This pro-

vision was brought into the Code and given retroactive effect as a result of the decision in *United States v. Hendler*, 303 U. S. 564. That case held that liabilities assumed by a transferee must be regarded as "other property," and accordingly made taxable those exchanges or reorganizations which involved an assumption of liabilities, because the property was not transferred *solely* for stock or securities as the statute required in order to confer tax-free status.

To neutralize this effect of the assumption of liabilities, the Congress enacted the so-called "Hendler Amendment" (Section 213, Revenue Act of 1939, c. 247, 53 Stat. 862, Appendix, *infra*, pp. 22-25), which provided that in connection with a reorganization (the kind of transaction involved in the *Hendler* case) the assumption of a liability may be "disregarded" (Section 213 (b)), and also that in determining whether the proportionate interest test of Section 112 (b) (5) is met, in the case of an exchange such as this, the value of assumed liabilities may be regarded as "stock or securities." (Section 213 (c).) When applied to the present case, the amendment makes the changes in the interests of the transferors minute regardless of whether the "relative value" test or the "proportionate interest" test is used. See Table I, *supra*, p. 7; *infra*, pp. 13-16. The taxpayer contends, however (Br. 22-26) that such result does not follow because under Section 112 (k)

Internal Revenue Code, Appendix, *infra*, pp. 20-21,² the amounts of stock or securities received must be proportionate prior to the computation *including* the liabilities. The Tax Court (R. 22a-25a) and the court below (R. 35-38) rejected this contention for reasons which, on analysis, are clearly correct. The amounts of assumed liabilities are an obvious factor in the determination of the respective amounts of stock and securities to be received by each of the transferors and to ignore them in an initial test of proportionate interests would mean the adoption of a rule equivalent to that which was discarded by the "Hendler" amendment. The courts below, therefore, rightly concluded that the taxpayer's view would tend greatly to thwart the congressional purpose of extending tax-free treatment to exchanges in which insubstantial variations in the ownership interests of the transferors are made when liabilities are *included* in the reckoning.

This case is the first to present the issue. It is of infrequent occurrence and we are aware of no other case involving the question which has been brought into litigation. The decision is correct and, as stated, there is no conflict. It does not warrant review.

Issue No. 2. This issue raises the proper method of calculating the proportionate interests,

² Section 112 (k) of the Internal Revenue Code, *infra*, pp. 20-21, is the equivalent of Section 213 (f) of the Revenue Act of 1939, *infra*, pp. 23-24.

aside from the effect of the "Hendler Amendment." (It would only be necessary to decide this question if the first issue were decided contrary to our views). Under the test adopted by the court below (called the "proportionate interest" or "control" test), if the variance in a transferor's position after the exchange is slight in proportion to the whole, the statute is deemed to be satisfied, no gain or loss is recognized, and the transferor's basis for the property is taken by the transferee. In this view, one of the transferors (Gilbert Mather) contributed 8.33% of the net value of the assets and received 9.17% of the stock, a change of but +0.84%, while another (Josephine Mather) contributed 8.33% and received 7.31%, a change of -1.02%.^{2a} Neither of these changes, less than 2% of the whole, made the interests substantially disproportionate, and no gain or loss was therefore recognized. This construction appears to have been adopted in numerous other cases. *Diescher v. Commissioner*, 110 F. 2d 90 (C. A. 3); *Budd*

Transferors	(a) Net value of assets at time of transfer	(b) Percent- age of total	(c) Value of stock issued to transferor	(d) Percent- age of total	(e) Column (d) minus column (b)
Charles Mather.....	\$393,750	72.92	\$392,300	72.65	-0.27
Victor Mather.....	56,250	10.43	58,700	10.87	+0.45
Gilbert Mather.....	45,000	8.33	49,800	9.17	+0.84
Josephine Mather.....	45,000	8.33	39,800	7.31	-1.02
Total.....	\$540,000	100.00	\$540,000	100.00	-----

International Corp. v. Commissioner, 143 F. 2d 784 (C. A. 3), certiorari denied, 323 U. S. 802; *Hartford-Empire Co. v. Commissioner*, 137 F. 2d 540 (C. A. 2); *Hillyer, Edwards, Fuller v. United States*, 52 F. 2d 742 (E. D. La.); *Record Petroleum Co. v. Commissioner*, 32 B. T. A. 1270; *Ared Corp. v. Commissioner*, 30 B. T. A. 1080; *Gladstone Corp. v. Commissioner*, 37 B. T. A. 174; *Straubel v. Commissioner*, 29 B. T. A. 516; *Rissman v. Commissioner*, 6 T. C. 1105; *Strouse, Adler Co. v. Commissioner*, decided June 19, 1944 (1944 P-H T. C. Memorandum Decisions, par. 44,219); *American Security Co. v. Commissioner*, decided June 25, 1943 (1943 P-H T. C. Memorandum Decisions, par. 43,308); *Vickers v. Commissioner*, decided June 25, 1942 (1942 P-H B. T. A. Memorandum Decisions, par. 42,379); *Fernhome Co. v. Commissioner*, decided November 13, 1934 (1934 P-H B. T. A. Memorandum Decisions, par. 34,503). Cf. *Skouras v. Commissioner*, 45 B. T. A. 1024. Although it would have made no difference in each of these cases whether the "proportionate interest" test or the "relative value" test, for which the taxpayer contends here, had been adopted, nonetheless the court's comparison of the percentages in each case accords with the "proportionate interest" test.

The taxpayer's position is that the variance must be considered first from the viewpoint of each individual transferor and that variance then

contrasted with the change in every other transferor's interest. Thus, it would compute the percentage changes in Gilbert Mather's interest to be +10.0% and in Josephine Mather's, -12.2%, and conclude that their interests have changed by 22.2%.²³ This type of comparison has been called the "relative value" test. *Bodell v. Commissioner*, 154 F. 2d 407, 410 (C. A. 1). As the court below pointed out (R. 24), such a construction reads into the statute a wholly different test from that called for by its purpose and wording. Since Section 112 (b) (5) results in gain or loss being recognized to all or none of the transferors, it follows that the changes in their interests should be considered in the context of the entire transaction. So considered, a change in an individual transferor's interest, though comparatively large with respect to him alone, loses importance when measured against the entire assets transferred and the entire stock and securities received by all transferors. Sig-

	(a) Net value of assets at time of transfer	(b) Value of stock issued to trans- feror	(c) Gain	(d) Loss	(e) Individ- ual gain or loss percent- age
Charles Mather.....	\$393,750	\$392,300		\$1,450	-0.3
Victor Mather.....	56,250	58,700	\$2,450		+4.4
Gilbert Mather.....	45,000	49,500	4,500		+10.0
Josephine Mather.....	45,000	39,500		5,500	-12.2
	\$540,000	\$540,000			

nificantly, the "relative value" test makes taxable only those exchanges in which the *smaller* transferor has his interest changed proportionately greater than those who transfer the bulk of the assets involved. However, any exchange which is tax-free under the "relative value" test is equally tax-free under the "control" test adopted by the court below.

These considerations, clearly relevant under the "reasonably liberal policy" of the statute,³ were overlooked or disregarded in both of the cases (*Bodell v. Commissioner, supra*, and *United Carbon Co. v. Commissioner*, 90 F. 2d 43 (C. A. 4)) cited by the taxpayer as in conflict with the present case.

We believe the conflict, if it exists with either of the cases, to be one in principle merely, and not in result. In the *Bodell* case the court was not called upon by the issues presented to choose between the "relative value" and the "control" tests. The Commissioner had argued that under either test the interests received by the transferors were disproportionate and the exchange not tax-free. The choice made by the court between the two tests was therefore unnecessary to its decision. Under the Commissioner's contentions, the result reached is in accord with that

³ 3 Mertens, Law of Federal Income Taxation, Sec. 20.41, p. 154. Cf. S. Rep. No. 275, 67th Cong., 1st Sess., p. 11 (1939-1 Cum. Bull. (Part 2) 181, 188-189); *Halliburton v. Commissioner*, 78 F. 2d 265 (C. A. 9).

of the present case and the statement of contrary views found in the *Bodell* case gives rise only to a technical conflict.*

Similarly, the force of the decision in the *United Carbon* case has been dissipated. The *Bodell* opinion (p. 412) points out that the reasoning of the *United Carbon* opinion is unsound. Moreover, the Court of Appeals for the Fourth Circuit specifically rejected the result of that case when, in a later proceeding (*Britt v. Commissioner*, 114 F. 2d 10 (C. A. 4)), it held the identical exchange to be tax-free under Section 203 (b) (3) of the Revenue Act of 1926, c. 27, 44 Stat. 9 (which corresponds with Section 112 (b) (4) of the Internal Revenue Code). This was precisely the contrary of the result in the *United Carbon* case, which held the same exchange taxable under Section 203 (b) (4) of the 1926 Act (which corresponds with Section 112 (b) (5) of the Internal Revenue Code). As to the changed result the court said (p. 13), "Such would have been our decision in the prior case had the Commissioner" cited subsection 203 (b) (3) to support his position. Thus, the conflict alleged does not touch upon the ultimate results in either of the two cases cited.

In the light of the nature of the asserted conflict, and of the existence of a correct and ade-

*The *Bodell* case is typical in that it is infrequent for a difference between application of one test or the other to be decisive for a determination of tax-free status.

quate basis for the decision below which does not warrant review, we believe that there is no sufficient reason for this Court to consider the second issue in this case.

CONCLUSION

For the reasons stated, the petition for a writ of certiorari should be denied.

Respectfully submitted.

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MAY 1949.

APPENDIX

Internal Revenue Code:

SEC. 112. RECOGNITION OF GAIN OR LOSS.

* * * * *

(k) [as added by Sec. 213, Revenue Act of 1939, c. 247, 53 Stat. 862, and as amended by Sec. 121, Revenue Act of 1943, c. 63, 58 Stat. 21] *Assumption of Liability not Recognized.*—Where upon an exchange the taxpayer receives as part of the consideration property which would be permitted by subsection (b) (4), (5), or (10) of this section to be received without the recognition of gain if it were the sole consideration, and as part of the consideration another party to the exchange assumes a liability of the taxpayer or acquires from the taxpayer property subject to a liability, such assumption or acquisition shall not be considered as "other property or money" received by the taxpayer within the meaning of subsection (c), (d), or (e) of this section and shall not prevent the exchange from being within the provisions of subsection (b) (4), (5), or (10); except that if, taking into consideration the nature of the liability and the circumstances in the light of which the arrangement for the assumption or acquisition was made, it appears that the principal purpose of the taxpayer with respect to the assumption or acquisition was a purpose to avoid Federal income tax on the exchange, or, if not such purpose, was not a bona fide business purpose, such assumption or acquisition (in

the amount of the liability) shall, for the purposes of this section, be considered as money received by the taxpayer upon the exchange. In any suit or proceeding where the burden is on the taxpayer to prove that such assumption or acquisition is not to be considered as money received by the taxpayer, such burden shall not be considered as sustained unless the taxpayer sustains such burden by the clear preponderance of the evidence.

* * * * *

(26 U. S. C. 1946 ed., Sec. 112.)

SEC. 113. ADJUSTED BASIS FOR DETERMINING GAIN OR LOSS.

(a) *Basis (Unadjusted) of Property.*—The basis of property shall be the cost of such property; except that—

* * * * *

(8) *Property Acquired by Issuance of Stock or as Paid-In Surplus.*—If the property was acquired after December 31, 1920, by a corporation—

(A) by the issuance of its stock or securities in connection with a transaction described in section 112 (b) (5) (including, also, cases where part of the consideration for the transfer of such property to the corporation was property or money, in addition to such stock or securities), or

(B) as paid-in surplus or as a contribution to capital,

then the basis shall be the same as it would be in the hands of the transferor, increased in the amount of gain or decreased in the amount of loss recognized to the transferor upon such transfer under the law applicable to the year in which the transfer was made.

* * * * *

(26 U. S. C. 1940 ed., Sec. 113.)

Revenue Act of 1926, c. 27, 44 Stat. 9:

SEC. 203. * * *

(b) * * *

(4) No gain or loss shall be recognized if property is transferred to a corporation by one or more persons solely in exchange for stock or securities in such corporation, and immediately after the exchange such person or persons are in control of the corporation; but in the case of an exchange by two or more persons this paragraph shall apply only if the amount of the stock and securities received by each is substantially in proportion to his interest in the property prior to the exchange.

Revenue Act of 1939, c. 247, 53 Stat. 862:

SEC. 213. ASSUMPTION OF INDEBTEDNESS.

(b) *Amendment to Definition of Reorganization.*—Section 112 (g) (1) of the Internal Revenue Code (relating to definition of reorganization) is amended to read as follows:

“(1) The term ‘reorganization’ means * * * (C) the acquisition by one corporation, in exchange solely for all or a part of its voting stock, of substantially all the properties of another corporation, but in determining whether the exchange is solely for voting stock the assumption by the acquiring corporation of a liability of the other, or the fact that property acquired is subject to a liability, shall be disregarded, * * *.”

(c) *Requirement of Substantially Proportionate Interests.*—Section 112 (b) (5) of the Internal Revenue Code (relating

to requirement of substantially proportionate interests) is amended by adding at the end thereof the following new sentence: "Where the transferee assumes a liability of a transferor, or where the property of a transferor is transferred subject to a liability, then for the purpose only of determining whether the amount of stock or securities received by each of the transferors is in the proportion required by this paragraph, the amount of such liability (if under subsection (k) it is not to be considered as 'other property or money') shall be considered as stock or securities received by such transferor."

* * * * *

(f) *Assumption of Liability not Recognized under Prior Acts.*—

(1) Where upon an exchange occurring in a taxable year ending after December 31, 1923, and beginning before January 1, 1939, the taxpayer received as part of the consideration property which would be permitted by subsection (b) (4) or (5) of section 112 of the Revenue Act of 1938, or the corresponding provisions of the Revenue Act of 1924 or subsequent revenue Acts, to be received without the recognition of gain if it were the sole consideration, and as part of the consideration another party to the exchange assumed a liability of the taxpayer or acquired from the taxpayer property subject to a liability, such assumption or acquisition shall not be considered as "other property or money" received by the taxpayer within the meaning of subsection (c), (d), or (e) of section 112 of the Revenue Act of 1938, or the corresponding provisions of the Revenue Act of 1924 or subsequent revenue Acts,

and shall not prevent the exchange from being within the provisions of subsection (b) (4) or (5) of section 112 of the Revenue Act of 1938, or the corresponding provisions of the Revenue Act of 1924 or subsequent revenue Acts; except that if, in the determination of the tax liability of such taxpayer for the taxable year in which the exchange occurred, by a decision of the Board of Tax Appeals or of a court which became final before the ninetieth day after the date of enactment of the Revenue Act of 1939, or by a closing agreement, gain was recognized to such taxpayer by reason of such assumption or acquisition of property, then for the purposes of section 112 of the Revenue Act of 1938, and corresponding provisions of the Revenue Act of 1924 or subsequent revenue Acts, such assumption or acquisition (in the amount of the liability considered in computing the gain) shall be considered as money received by the taxpayer upon the exchange.

(2) Paragraph (1) shall be effective with respect to the Revenue Act of 1924 and subsequent revenue Acts as of the date of enactment of each such Act.

* * * * *

(26 U. S. C. 1946 ed., Sec. 112.)

(h) *Substantially Proportionate Interests Under Prior Acts.*—

(1) Section 112 (b) (5) of the Revenue Acts of 1938, 1936, 1934, 1932, and 1928, and section 203 (b) (4) of the Revenue Acts of 1926 and 1924 are amended by inserting at the end thereof the following: "Where the transferee assumes a liability of a transferor, or where the property of a transferor is transferred subject to a liability, then for the purpose only of de-

termining whether the amount of stock or securities received by each of the transferors is in the proportion required by this paragraph, the amount of such liability (if under section 213 of the Revenue Act of 1939 it is not considered as 'other property or money') shall be considered as stock or securities received by such transferor. If, as the result of a determination of the tax liability of the taxpayer for the taxable year in which the exchange occurred, by a decision of the Board of Tax Appeals or of a court which became final before the ninetieth day after the date of the enactment of the Revenue Act of 1939, or by a closing agreement, the treatment of the amount of such liability was different from the treatment which would result from the application of the preceding sentence, such sentence shall not apply and the result of such determination shall be deemed proper."

(2) The amendments made by paragraph (1) to the respective Acts amended shall be effective as to each of such Acts as of the date of enactment of such Act.

* * * * *

Treasury Regulations 111, promulgated under the Internal Revenue Code:

SEC. 29.112 (b) (5)-2. TREATMENT OF ASSUMPTIONS OF LIABILITIES.—(a) *Recognition of gain.*—For the effect upon the recognition of gain of an assumption of liabilities in a transfer described in section 112 (b) (5), see section 112 (k) and the regulations prescribed thereunder.

(b) *Computation of proportionate interests required by section 112 (b) (5).*—In any case where an assumption of liabilities is not to be treated as "other property

or money" under section 112 (k), the liabilities so assumed are, for the purpose of determining whether the stock or securities received by the transferors are substantially proportionate to their interests in the property transferred as required by section 112 (b) (5), to be treated as stock or securities received by the transferor whose indebtedness is assumed. * * *

SEC. 29.112 (k)-1 [as amended by T. D. 5402, 1944 Cum. Bull. 229]. ASSUMPTION OF LIABILITIES NOT TO BE TAKEN INTO ACCOUNT FOR PURPOSE OF RECOGNIZING GAIN OR LOSS.—(a) *General rule.*—Section 112 (k) does not affect the rule that liabilities assumed are to be taken into account for the purpose of computing the amount of gain or loss realized under section 111 upon an exchange. Subject to the exceptions and limitations specified in paragraph (b) of this section, section 112 (k) provides, however, that—

(1) Liabilities assumed are not to be treated as "other property or money" under section 112 (e) or for the purpose of determining the amount of the realized gain which is to be recognized under section 112 (c) or (d), if the transactions would, but for the receipt of "other property or money," have been exchanges of the type described in section 112 (b) (4), (5), or (10); and

(2) If the only type of consideration received by the transferor in addition to that permitted to be received by section 112 (b) (4), (5), or (10) consists of an assumption of liabilities, the transaction, if otherwise qualified, shall be deemed to be within the provisions of section 112 (b) (4), (5), or (10.)

With respect to an exchange described in section 112 (b) (10) or so much of section 112 (b) or (e) as refers to section 112 (b) (10), the provisions of section 112 (k) shall not affect the tax liability for any taxable year beginning before January 1, 1943.

The application of this paragraph may be illustrated by the following example:

Example.—A, an individual, transfers to a controlled corporation property with an adjusted basis of \$10,000 in exchange for stock of the corporation with a fair market value of \$8,000, cash in the amount of \$3,000, and the assumption by the corporation of indebtedness of A amounting to \$4,000. A's gain is \$5,000, computed as follows:

Stock received	\$8,000
Cash received	3,000
Liabilities assumed by transferee	4,000
<hr/>	
Total consideration received	15,000
Less: Adjusted basis of property transferred	10,000
<hr/>	
Gain realized	5,000

Assuming that the transaction falls within section 112 (c) as a transaction which would have been within section 112 (b) (5) but for the receipt of "other property or money", only so much of such \$5,000 gain will be recognized as does not exceed the "other property or money" received. Since section 112 (k) provides that an assumption of liabilities shall not constitute "other property or money" for this purpose, the only "other property or money" received is the \$3,000 cash, and the \$5,000 realized gain will be recognized only to that extent.

(b) *Exceptions and limitations.*—The benefits of section 112 (k) do not extend to any exchange involving an assumption of

liabilities where it appears that the principal purpose of the taxpayer with respect to such assumption was a purpose to avoid Federal income tax on the exchange, or, if not such purpose, was not a bona fide business purpose. In such cases, the amount of the liabilities assumed shall, for the purpose of determining the amount of gain to be recognized upon the exchange in which the liabilities are assumed, be treated as money received by the taxpayer upon the exchange. In any suit or proceeding where the burden is on the taxpayer to prove that an assumption of liabilities is not to be treated as "other property or money" under section 112 (k), which is the case if the Commissioner determines that the taxpayer's purpose with respect thereto was a purpose to avoid Federal income tax on the exchange or was not a bona fide business purpose and the taxpayer contests such determination by litigation, the taxpayer must sustain such burden by the clear preponderance of the evidence. Thus, the taxpayer must prove his case by such a clear preponderance of all the evidence that the absence of a purpose to avoid Federal income tax on the exchange, or the presence of a bona fide business purpose, is unmistakable.

T. D. 4939, 1939-2 Cum. Bull. 112, 116, 118:

* * * *

Pursuant to section 213 of the Revenue Act of 1939 and other provisions of the internal revenue laws, the following regulations are hereby prescribed:

* * * *

SEC. 20A.3. *Assumption of liability not to be taken into account for purpose of recognizing gain or loss—(a) General*

rule.—Section 213 of the Act does not affect the rule that liabilities assumed are to be taken into account for the purpose of computing the amount of gain or loss realized upon an exchange. Such section provides, however, that liabilities assumed are not to be treated as “other property or money” under section 112 (e) or for the purpose of determining the amount of the realized gain which is to be recognized under section 112 (c) or (d), if the transactions involved would, but for the receipt of “other property or money,” have been exchanges of the type described in section 112 (b) (4) or (5). The section also provides that if the only type of consideration received by the transferor in addition to that permitted to be received by section 112 (b) (4) or (5) consists of an assumption of liabilities, the transaction, if otherwise qualified, shall be deemed to be within the provisions of section 112 (b) (4) or (5). The above rules are applicable to all transactions of the character described occurring at any time in the past or the future in a taxable year ending after December 31, 1923, of the transferor whose liabilities are assumed, with the exceptions and limitations specified in paragraphs (b) and (c) of this section of the regulations.

* * * * *

SEC. 20A.5 *Effect of assumption of liabilities on computation of proportionate interests required by section 112 (b) (5).*—

(a) *General rule.*—Subject to the limitations and exceptions specified in paragraph (b) of this section of the regulations, in any case where an assumption of liabilities is not to be treated as “other property or money” under section 213 (f) of the Act

or section 112 (k), added to the Internal Revenue Code by section 213 (a) of the Act, the amount of the liabilities so assumed is to be treated as stock or securities received by the transferor whose indebtedness is assumed, for the purpose of determining whether the stock or securities received by the transferors are substantially in proportion to their interests in the properties transferred, as required by section 112 (b) (5). The application of this paragraph may be illustrated by the following example:

Example: A and B, individuals, each own property with a fair market value of \$100,000 on July 1, 1939. There is a purchase money mortgage on A's property of \$50,000. On July 1, 1939, A and B organize the X Corporation, to which they transfer the property above described for the entire capital stock of the X Corporation and the assumption by the X Corporation of A's purchase money mortgage. The X Corporation's capital stock is divided as follows: \$50,000 to A and \$100,000 to B. Nevertheless, for the purposes of determining whether the transferors received stock or securities substantially in proportion to their interests in the properties transferred, as required by section 112 (b) (5), A is deemed to have received stock or securities to the extent of \$100,000, since his \$50,000 purchase money mortgage, assumed by the X Corporation, is also to be treated as stock or securities received by him. Accordingly, under the facts as stated, the proportions required by section 112 (b) (5) exist.

* * * * *